

# TAXATION

## ON SALE AND PURCHASE OF PROPERTY

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## BRIEF INTRODUCTION

- Service tax is presently calculated at the rate of 15% of the gross value of the property. But as there is a government abatement of 75% (increased from 67%), tax will be levied only on 25% of the gross value of the property. The effective rate of service tax at present is therefore 3.75%
- The effective rate of service tax has gone up to 15% w.e.f. from 1<sup>st</sup> June 2016 due to the introduction of the Krishi Kalyan Cess (KKC) at 0.5% on the value of taxable service.

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- The rationale behind the 75% rebate is that the service tax is leviable only on services and not on the value of the land. Therefore taking notionally the value of the land to be 75%, tax is imposed on the balance 25%.
- Service Tax is leviable only on properties which are under construction and sold or agreed to be sold before the stage of completion certificate.
- No service tax is chargeable on sale of fully constructed properties, sold after obtaining building use permission.

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## REAL ESTATE AGENT & CONSULTANT

- “Real estate agent” means a person who is engaged in rendering any service in relation to sale, purchase, leasing or renting, of real estate and includes a real estate consultant. (Section 65(56) of Finance Act, 1994 as amended)
- Real estate consultant” means a person who renders in any manner, either directly or indirectly, advice, consultancy or technical assistance, in relation to evaluation, conception, design, development, construction, implementation, supervision, maintenance, marketing, acquisition or management, of real estate. (Section 65(57) of Finance Act, 1994 as amended)

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## **TAXABLE EVENT & SCOPE OF SERVICE:**

- Taxable service means any service provided to a client, by a real estate agent in relation to real estate. (Section 65 (72) (v) of Finance Act, 1994 as amended)
- Some international realty concerns, such as Richard Ellis, Colliers and Jardine etc. have opened shop in India and they are providing comprehensive realty services.

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- Apart from the traditional services in respect of sale/purchase/leasing of real estate such concerns are, inter alia, providing services to real estate developers and promoters in respect of evaluation of a proposed real estate scheme/project by conducting techno-economic studies, providing feasibility reports and by even helping in marketing real estate projects. Such services shall also attract Service Tax.
- Value of the taxable services shall be the gross amount charged by the service provider for such service rendered by him. (Section 67 of Finance Act, 1994 as amended)

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## EXEMPTION & EXCLUSION

- The activity of actual construction of any building, carried out by builders/developers would not attract Service Tax levy, as it is not a service within the meaning of the term real estate agent or real estate consultant. (Ministry's F.No.B11/3/98-TRU dt.07.10.1998)
- There is only one situation in which the builder does not have to pay service tax when he sells an under-construction property: When he sells a building after a completion certificate is obtained from local authority and entire consideration is obtained from the buyer only after building completion certificate is obtained.
- Service Tax on Under Construction Property @ 3.75% (w.e.f. 1<sup>st</sup> June 2016)

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Therefore, although paying Service Tax is mandatory, it can be avoided if:

(a) The builder has obtained a completion certificate from the issuing authority.

(b) The buyer has paid the entire consideration only after the building completion certificate had been obtained by the builder.

You can even get the completion certificate from an architect or chartered engineer or licensed surveyor. It is not necessary to go to a Government authority to get the completion certificate. You may rely on the notification issued by the Government of India (D.O.F.No.334/03/2010-TRU) which reads as follows:

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*“Before the issuance of completion certificate if agreement is entered into or any payment is made for sale of complex or apartment in residential complex, service tax will be levied on such transaction since the builder provides the construction service. Completion certificate issued by a Government authority was prescribed as demarcation by introducing an Explanation in the Finance Act.*

Completion certificate issued by an architect or chartered engineer or licensed surveyor can be now taken to determine the service tax liability.

However, this exemption above is only from paying Service Tax. You will have to pay Stamp Duty on the sale value of the property if you purchase property after construction.

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## SERVICE TAX ON UNDER CONSTRUCTION PROPERTY

- Service Tax on under Construction Property is levied on the Services provided by Builders or Real Estate Developers or any other person, where Building Complexes, Civil Structure or part thereof are offered for sale but the Payment is received before the Issuance of Completion Certificate by a Competent Authority.
- To remove confusions created by the Court Orders, the Govt while introducing the Negative List of Services (applicable from 1st July 2012), has very specifically in the definition of Service contained in Clause (44) of Section 65B of the Act stated that Service includes Declared Service. The Govt. has also mentioned the activities which would be considered as Declared Services and Construction of Complex, Building, Civil Structure or part thereof has been stated as a Declared Service.

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## **EXEMPTION FROM PAYMENT OF SERVICE TAX ON CONSTRUCTION**

- The Ministry of Finance on 20th June 2012 issued a Mega Notification pertaining to exemption from applicability of Service Tax on many activities. As per this Notification No. 25/2012-Service Tax dated 20th June 2012, Exemption from Service Tax on Under Construction Property is available in circumstances pertaining to services provided in the following cases:-

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- Construction of Low Cost Houses up to a carpet area of 60 sq. metres per house in a housing project approved by competent authority empowered under the “Scheme of Affordable Housing in Partnership” framed by the Ministry of Housing and Urban Poverty Alleviation by the Govt. of India
- Single Residential Unit has been defined as a self contained residential unit designed for use of a single family. If the house/complex has multiple floors/units and the title of each of the units/floors is capable of being transferred to another person by Mutation in land/municipal records, all the floors/units would be considered as separate single residential units and Service Tax on Construction would be levied on the same.

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## COMPUTATION OF SERVICE TAX ON UNDER CONSTRUCTION PROPERTY

- At the time of sale of property, the amount paid by the purchaser to the Builder is for value of Land and Construction Service provided by the Builder/Developer.
- Service Tax can only be levied on Services and not on sale of goods/immovable property & therefore in the above case Service Tax won't be levied on the Value of Land and would only be levied on the Construction Service provided by the Builder/Developer as per the rates in force which currently is 15% (applicable from 1<sup>st</sup> June 2016) (incl. of Education Cess and Secondary, Higher Education Cess (SHEC), Swachh Bharat Cess (SBC) & Krishi Kalyan Cess (KKC) on the value of taxable services.)

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- The Service Tax on Construction would be levied as per the rates in force on the total value of services provided by the Builder/Developer provided the purchase price of land and the value of construction services are shown separately in the Invoice
- In cases where it is difficult to show the cost of goods/immovable property and the cost of services separately, the Govt issues an Abatement scheme wherein tax is levied on a small proportion of the Total Amount.
- Abatement Scheme has also been announced for the service of Construction of Building and as per Notification No. 26/2012-Service Tax dated 20/6/2012, an abatement of 75% is allowed and Service Tax would be levied only on 25% of the total purchase price (incl. of price paid for Land).

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- So Service Tax @ 15% on 25% of the Total Purchase price is levied on under Construction Property. In other words, w.e.f. 1<sup>st</sup> June 2016, Service Tax @ 3.75% (25% of 15%) is levied on the total price paid for the purchase of an under construction property.
- The Budget 2013 brought in an amendment to the above provisions and reduced the abatement from 75% to 70% for flats above 2000 sq. feet or costing Rs. 1 Crore and above. In such cases, the Service Tax shall be charged on 30% of the amount (70% abatement). In other words, Service Tax in such cases shall be charged @ 4.5%.

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## **COMPUTATION OF SERVICE TAX ON UNDER CONSTRUCTION PROPERTY**

<b>Particulars</b>	<b>Abatement Allowed</b>	<b>Taxable Component</b>	<b>Normal Rate of Service Tax (w.e.f. 1<sup>st</sup> June 2016)</b>	<b>Effective Rate of Service Tax on Property</b>
<b>Flat size over 2000 sqft</b>	70%	30%	15%	4.5%
<b>Sale price of Flat over Rs 1 Crore</b>	70%	30%	15 %	4.5%
<b>In all other cases except specifically exempted (as mentioned above)</b>	75%	25%	15 %	3.75%



The Ministry of Finance vide Notification No. 9/2013 has re-confirmed that the above abatement provided for payment of service tax on property can be availed by the builder only if:-

- Cenvat Credit on inputs used for providing the service has not been availed
- Total amount charged includes the value of land and the value of land is not shown separately in the invoice.

The Service Tax so collected by the Builders/Real Estate Developers does not go in their pockets and is deposited with the Govt. by the person collecting the same before the due date of payment of Service Tax.

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## **SERVICE TAX ON RENT PAYABLE**

- In the past few years, there has been much confusion regarding the applicability of Service Tax on Rent. The Govt's stand was different to what the Courts had to say regarding the applicability of Service Tax on Rent which lead to confusions regarding whether service tax on renting of immovable property is payable or not.
- To remove all such confusions, the Govt while introducing the Negative List of Services regime in Service Tax (which came in effect from 1st July 2012), the Govt has in the definition of 'service' contained in Clause (44) of Section 65B, specifically mentioned that Service includes a "Declared Service".

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- Declared Services are those services which would be deemed to be a service (whether it is a service or not), and Service Tax would be payable on the same. The Govt has specifically mentioned the services which would be considered as Declared Services and Renting of Immovable Property has been specifically mentioned as a Declared Service.
- In the light of the above changes, Service Tax on Renting of Immovable Property is liable to be paid as per the rates in force.

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# EXEMPTION FROM SERVICE TAX ON RENT

Consideration received for the following types of activities has been specifically exempted from the applicability of Service Tax on renting of immovable property:

Renting of Vacant Land, relating to Agriculture

Renting of Residential dwelling units for use as Residence\*

Renting out any property by the Reserve Bank of India

Renting out any property by a Government or a Local Authority to a non-business entity

Only Residential units let-out for use as Residence are exempted. Service Tax on Residential units let-out for the purpose of any commercial activity would come under the purview of tax and thus service tax would be liable to be paid on Residential Units let-out for the purpose of any commercial activity.

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Renting or permitting usage of any property for a temporary purpose like conduct of a marriage or any other social function would also be taxable.

Service Tax is only mandatorily liable to be paid if the total value of services provided by the service provider exceeds the threshold limit of Rs. 10 Lakhs p.a. If the total value of all services provided by the service provider is less than Rs. 10 Lakhs p.a., he is not mandatorily liable to pay service tax.

The Service Tax on Rent collected by the Service Provider from the Service Recipient is required to be deposited with the Central Govt before the Due Date of Payment of Service Tax.

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The Ministry of Finance vide Notification No. 29/2012 Service Tax dated 20th June 2012, announced that Service Tax is to be levied on the

Gross Amount charged for renting of such immovable property  
(Less)

Taxes on Such Property namely property tax levied and collected by Local Authorities.

However, any amount such as Interest, Penalty paid to the Local Authority by the Service Provider on account of delayed payment of Property Tax or for any other reason shall not be treated as Property Tax for the purpose of deduction from the Gross Amount Charged.

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Computation of Service Tax on Rent can be explained with the help of the following example

Rent Received for the Year:	Rs. 25 Lakhs
Property Tax paid for the Year:	Rs. 1 Lakh

Rs. 24 Lakhs

Service Tax on Rent as per the rates in force would be payable on the above Rs. 24 Lakhs. The Current Rate of Service Tax is 15% (w.e.f. 1<sup>st</sup> June 2016) (incl. of Education Cess, SHEC, SBC & Krishi Kalyan Cess (KKC))

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## TDS ON SALE OF PROPERTY

The Finance Bill 2013 has proposed that purchaser of an immovable property (other than rural agricultural land) worth Rs 50 lakh or more is required to pay tax deducted at source at the rate of 1% from the consideration payable to a resident transferor.

Who is responsible to deduct the TDS on sale of Property?

According to rules in respect of tax deducted at source, buyer of the property would have to deduct the TDS and deposit the same in Government treasury.

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## **SHOULD EVERY BUYER MUST HAVE TAN ?**

Buyer or Purchaser of the property is not required to procure Tax Deduction Account Number (TAN). The Buyer is required to quote his or her PAN and sellers PAN.

PAN of the seller is mandatory. The same may be acquired from the Seller before effecting the transaction.

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## HOW TO PAY TDS ON SALE OF PROPERTY

The Buyer of the property (deductor of tax) has to furnish information regarding the transaction online on the TIN website. After successfully providing details of transaction deductor can:

- Either make the payment online (through e-tax payment option) immediately;
- Or make the payment subsequently through e-tax payment option (net-banking account) or by visiting any of the authorized Bank branches. However, such bank branches will make e-payment without digitization of any challan. The bank will get the challan details from the online form filled on [www.tin-nsdl.com](http://www.tin-nsdl.com)

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## WHAT IS CAPITAL GAIN ON PROPERTY ??

There are various asset classes such as equity, debt, gold and real estate in which you invest according to the time horizon of your financial goals and risk appetite. The gains from these investments are termed as capital gains and are taxed differently. Since any tax liability impacts your returns from the investment, it's important to have awareness on the net gains you will receive.

The capital gains from the equity, debt, gold and real estate asset classes are classified as long-term or short-term gains, based on the holding period of investment.

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For example, in real estate, if you have held the asset for more than 3 years, it is treated as long term. Contrary to this, in equities investment for more than a year is treated as long term. Long-term capital gains are usually taxed at a lower rate than regular income, which is done to encourage entrepreneurship and also investment in the economy.

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## HOLDING PERIOD FOR LONG-TERM GAINS IN VARIOUS ASSET CLASSES AND THE APPLICABLE TAX RATE:

Asset	Min. holding period for Long Term Gains	Taxation *
Equity	1 year	Zero
Debt	1 year	Whichever is beneficial- 10% without indexation 20% with Indexation benefit
Real Estate	3 year	20% with indexation benefit
Gold	3 year Physical Gold, e-Gold	20% with indexation benefit
	1 year Gold ETF Gold MF	Whichever is beneficial- 10% without indexation 20% with Indexation benefit
Bonds/NCDS	1 year	10% without any indexation benefit

**\*Education Cess of 3% is applicable on all tax rates**

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## MAXIMUM BENEFITS OF LONG TERM CAPITAL GAIN

As can be inferred from the data, equities enjoy zero taxability on long-term capital gains while in real estate or physical gold investment you have to pay a flat rate. "Due to these variations, the post-tax returns from these asset classes can vary substantially. There are provisions in income tax to reduce long-term capital gains (LTCG) through indexation or save LTCG tax by investing the gain in other alternatives.

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Thus, apart from reducing your tax liability through the indexation benefit, the tax on long-term capital gains can also be saved by investing these gains in specified securities for a certain period of time.

**Indexation Benefit:** Inflation constantly erodes the real value of money through the rise in prices. Due to this even if your investments have risen four times during a particular period, the purchasing power of money might have went down by, say, 50% from the time of your investment. "To reduce the impact of inflation on your investment, indexation benefit is provided in calculating long-term capital gains. Through this benefit you can adjust your capital gains from inflation by applying an appropriate factor from cost inflation index to the original units.

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## SHORT-TERM CAPITAL GAIN

Investment in any asset class, if held for a very short period, is taxed as short-term capital gains. Except equity, short-term gains from other assets are included in the investor's income and are taxed as per the slab rate.

The data below highlights the taxation structure in case of short-term capital gains:

<b>Asset</b>	<b>Holding period for Short Term Gains</b>	<b>Tax Rate*</b>
Equity	Less than 1 year	15%
Debt	Less than 1 year	Added to income
Gold	Physical/e-Gold- Below 3 year ETF/Gold MF - Below 1 year	Added to income
Real Estate	Below 3 year	Added to Income
Bonds/NCD	Less than 1 year	Added to Income

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## VAT ON PROPERTY

Value added tax is not levied per se on any transaction made with regards to any immovable property.

However VAT is levied on any “works contract” being entered upon with respect to the construction of an immovable property.

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## CONCLUSION

It is clear, thus, that with complex capital gains tax structure, it's wise to first make yourself aware of the net returns, i.e. post-tax returns, you will earn, whenever you intend to make any investment. This will help you in analyzing the amount of wealth you will create after paying your tax liabilities.

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